RICHARD RUSSELL'S **DOW THEORY LETTERS, INC.**

P. O. Box 1759, La Jolla, California 92038
Minimum of 26 Letters per year – $185 Annually
Registered with the Securities and Exchange Commission

December 1, 1982 **LETTER 849**

Nov. 19, DJIA 1021.15; PTI 1384; A-D Ratio –19.57
Nov. 26, DJIA 1007.36; PTI 1382; A-D Ratio –19.83

THE MARKET: The early-November highs for the D-J Averages were 1065.49 (Industrials) and 452.19 (Transports). Those joint highs are likely to stand for quite some time. The highs were reached at a time when the market was severely strained on the upside, when all 30 Dow Industrial shares were priced above their 200-day moving averages and when 90% of all stocks on the NYSE were above their 200-day moving averages (an extremely high figure).

The most vocal of the letter writers and Wall Street analysts are now stating that the 289 point rise of the Dow (August to November) was simply the first leg of "a monster bull market" that will ultimately take the Dow to the 2000 to 3000 area. Maybe so, but my own guess is that we have entered a protracted trading range which will lock the Dow into the area between 770 and 1070 for many months and perhaps a few years or so.

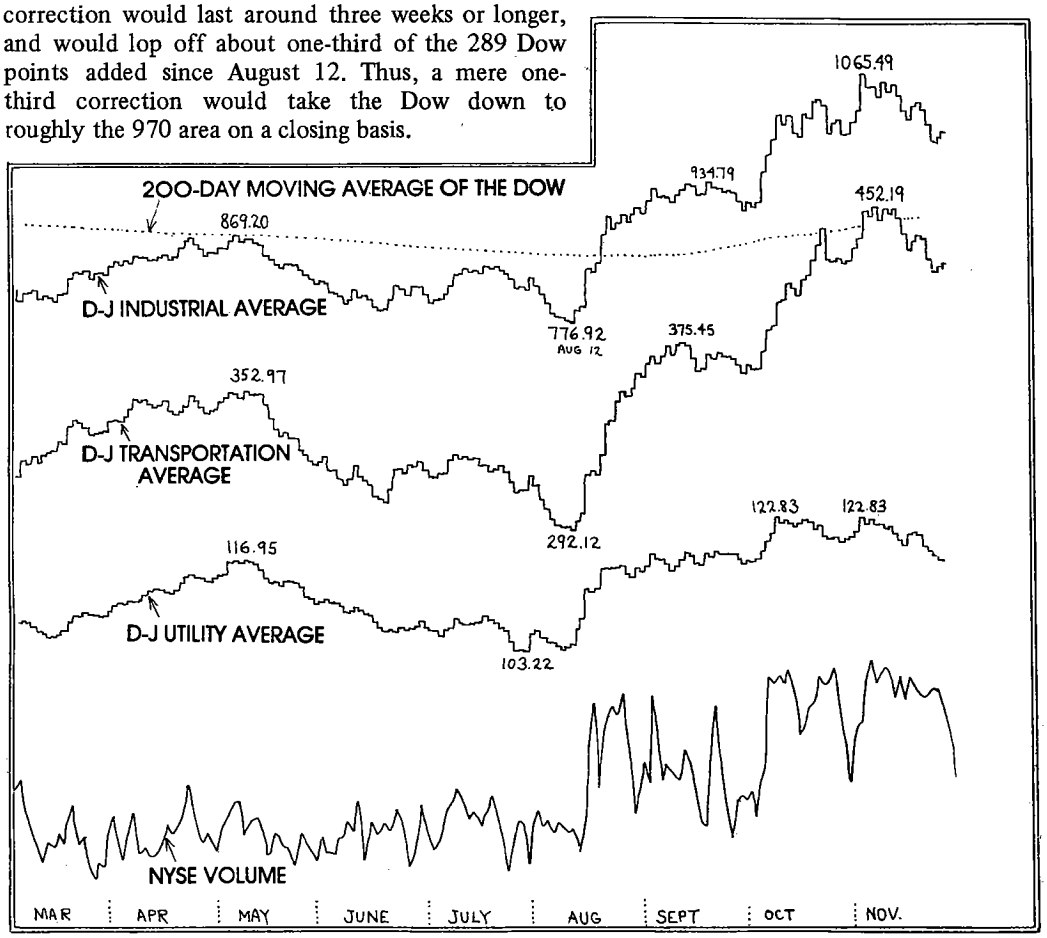
Meanwhile, the public is losing its fear of this market. We can see that in the greatly reduced selling ratios on the part of the odd-lotters. We can see it in the sharply reduced ratio of put options to call options.

The stock market has yet to undergo its first full correction of the August to November rise. A *minimum* (repeat minimum) correction would last around three weeks or longer, and would lop off about one-third of the 289 Dow points added since August 12. Thus, a mere one-third correction would take the Dow down to roughly the 970 area on a closing basis.

FRONT PAGE COMMENT: Over the last month the commodity price of heating oil has broken from a high of $1.05 to last week's $.86, a drop of 18%. Meanwhile, the broad Commodity Research Bureau Commodity Index has drifted listlessly just 3% off its lows. The extraordinary thing about all this is that it has occurred while the Fed has been pumping, while M-1 and M-2 have been rising sharply and while the adjusted monetary base has risen on an average (year-to-year comparison) of 8.1%.

I feel this action confirms what I've been saying all along: it's going to take another major injection of inflation to get this economy moving again. A modest amount of monetary inflation is just not going to cut it.

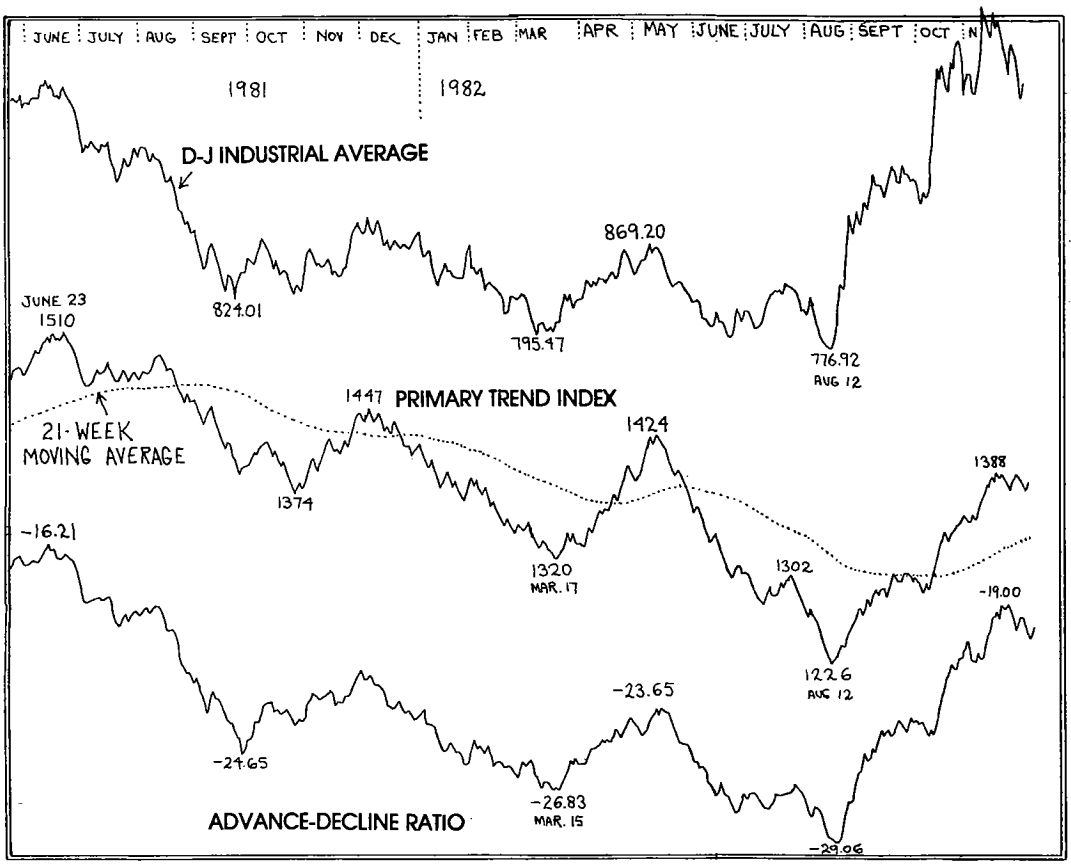
Why, what's wrong, why isn't the economy responding? The reason is the debt. The massive debts of this nation have its cities, states, citizens and businesses (as well as the federal government) in a vice-like grip. And at this point, it is going to take real, concerted credit creation (inflation) to unloosen the icy fingers of debt (deflation). The US (as I've written so many times) is faced with an "inflate or die" situation. So far, we aren't inflating fast enough! But don't despair, we could be on the way now.



In the last Letter I discussed the relationship between the Dow and its 200-day moving average. At the November 3 high the Dow was roughly 185 points (probably an all-time record) ABOVE its 200-day moving average. The 200-day MA is now rising, and the longer the Dow can hold in a high area, obviously the higher the 200-day MA will climb. But ultimately every advance (and decline) will return to make contact with the 200-day MA. This advance will be no exception.

Currently, the 200-day MA for the Dow is in the 890 area, which means that the Dow is still better than 100 points above its MA. It would, therefore, be perfectly normal for the Dow to correct by returning to the vicinity of the 200-day MA, a move which at present could easily take the Dow down to the 900 area.

One of the phenomena I have been watching is the relative SIZE of both the August "base" and the potential October-November



top. This advance sprang from an almost non-existent base of perhaps a week's duration (see page 1 chart). Yet the Dow has been forming a large potential top ever since early October. So we have a record-breaking advance from a miniscule bottom and a then large top. It's a most unusual picture.

Question: Russell, you still seem to have reservations about this market.

Answer: Yes I do, but I'll be more satisfied if I see a full correction and then some impressive action AFTER the correction. Frankly, I'm bothered by the fact that this is the best-advertised "bull market" in history. And I'm bothered by many other things, not the least being the tiny base and rather large top that is forming in the price structure.

Question: I note that tops are appearing in both Industrials and Transports. Could you comment on this?

Answer: We have the appearance of a head-and-shoulders top in both the major Averages, while the Utility Average has simply faded back into its August-September range of 116-118. On November 23 the Transportation Average broke support line at 420, and thus the top in the carriers is now completed. As far as the Industrial Average is concerend, any rally from here could be construed as a right shoulder, but a break below the 980 support line would suggest that the Industrial Average, like the Transportation Average had topped out.

A decisive Dow penetration of 980 would suggest a trip down to contact the 200-day MA of the Dow (this is the dotted line on the chart).

Next let's turn to the Primary Trend Index (PTI). This is my proprietary instrument, an amalgum of eight critical averages and indicators. The PTI is a technical tool that has served us well over the past 11 years. As a rule, a rising PTI means profits for stockholders while a falling PTI will invariably generate losses for those who hold stocks. The only problem–to define the trend of the PTI and guage the duration of such a trend.

The PTI recorded a bear market low of 1226 on August 12. From there it turned up, and in early October the PTI broke above its 21-week moving average. The PTI peak was registered on November 9 at 1388. But despite three weeks of market weakness, it is remarkable that the PTI has held rather closely to its recent peak levels. If there is weakness in the *near-term trend* of the PTI, it's hard to detect so far. For the record, the rising trend of the PTI would be reversed on a PTI reading of 1360 (almost 30 points below the current reading). For the record, the 21-week moving average of the PTI now stands at 1333 (49 points below the current level).

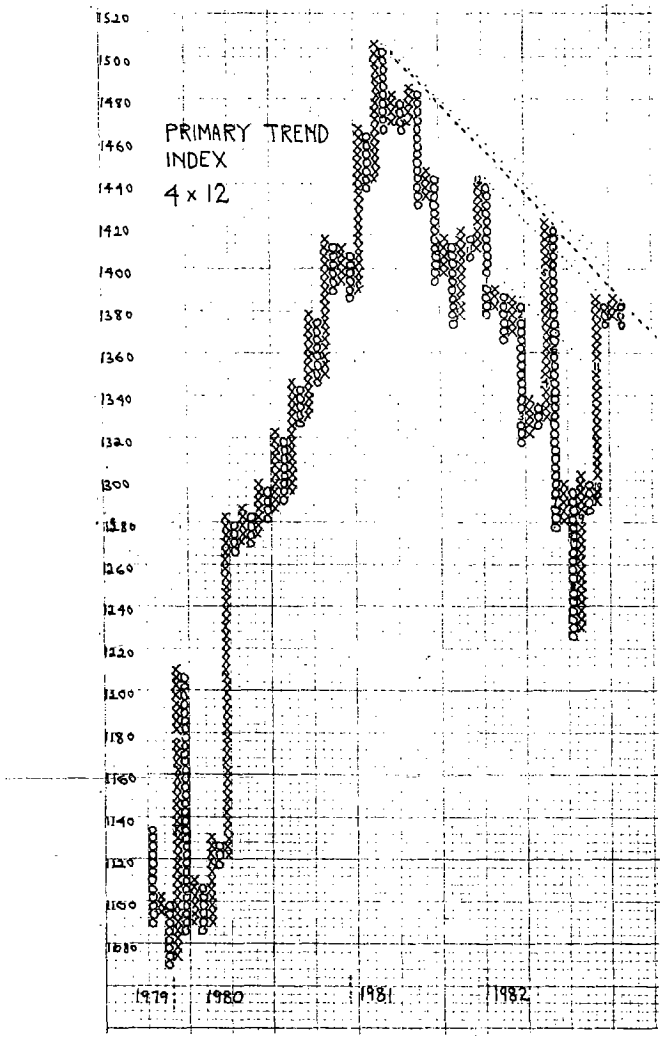
I have included (page 3) my longer-term point & figure chart of the PTI. Despite the historic 1065.49 high in the Dow (and the high in most other major averages), note that the PTI has not risen above its 1510 peak of June 23, 1981. Even more puzzling, the PTI has failed to rise above its May 11 peak of 1424. Thus, on the P & F chart we have a pattern of declining tops in the PTI. From the P & F standpoint, a value of 1396 would be long-term bullish, as it would reverse the long downtrend line as seen on this chart. Conversely, a drop to 1372 would constitute an important sell signal. As you can see, the PTI on its most recent (November) advance has again made contact with its declining trendline. This is the fifth attack on the bearish (declining) trendline since June, 1981.

Question: Russell, what do you really think lies behind the market's rise from the August lows?

Answer: I believe that the basic force behind the rise was the drop in the inflation rate with the accompanying decline in interest rates. With the drop in interest rates, the ratio of stock to bond yields improved tremendously in favor of stocks. Or, to put it another way, the spread between stock and bond yields contracted drastically, and this increased the relative attractiveness of stocks as compared with bonds.

Actually, we've seen a doubling of the Dow price/earnings ratio since 1980! In early 1980 the P/E on the Dow was 6.5. The P/E is now 13. Over the same period the actual earnings for the Dow have dropped drastically. So what we are seeing is a market that is paying almost twice the price today for Dow earnings compared with the price a year ago. This is fine–as long as earnings pick up in due time–to sustain the new price levels.

Question: What about the economic situation? How do you gear that to the market?



Answer: The news of the coming deficits is out. We face a rise of perhaps 50% in the national debt over the next three years. Right now the deficits are building and it is widely conceded that the 1983 could run up a $200 billion federal deficit. In the face of this, business profits are poor, companies are laying off thousands of workers and the GNP of the nation is flat if not down.

What we are seeing is an ominous situation, a situation I called attention to three or four years ago. The fact is that it's taking more and more credit creation to produce less and less in the way of growth in the economy. Without the current huge deficits this nation would be in a severe depression. And it's now a question of whether the coming $170 to $200 billion Federal deficit will be enough to pull us out of this recession.

Question: Russell, how do you think these deficits will affect us in coming years?

Answer: The deficits mean that we are continuing to "float" this nation's economy by borrowing from the future. Sadly, nothing has changed. And the tragic thing about deficits is that THEY DON'T GO AWAY. Each year's deficit is added to the previous total–so that the mountain of debt simply grows more massive. And all this debt has to be financed, re-financed and serviced.

Question: So how do we handle all these debts?

Answer: We go back to my old thesis–"inflate or die." But the incredible part of the situation is that even with today's huge new deficits, prices have at least temporarily ceased to rise. The US government is now going into debt at the rate of about $3.2 billion a week, but prices are actually under pressure, unemployment is high and business is rotten.

Question: How can this be?

Answer: It is happening because the nation is *not inflating fast enough.* Under today's onerous debt-ridden conditions, not enough inflation is deflationary. The nation is now so illiquid, the cost of carrying the debts is so high, that a growth of 10% in M-2 is NOT ENOUGH to float us out of recession. Thus, we are in a catch-22 situation where not enough inflation is deflationary, but the markets will not tolerate enough inflation to move the economy again.

Question: What do you mean, the markets won't tolerate enough inflation?

Answer: My guess is that it would take 25% or 30% inflation in M-2 to move this economy into boom times. But if M-2 went up at a 30% rate, the bond markets would panic and interest rates would push towards the highs again. Thus, inflation is no satisfactory answer–nor is deflation and depression a satisfactory answer.

Question: Then what is the stock market doing, rising as it did between August and today?

Answer: My belief is that (as I said before) the market has merely adjusted to lower bond yields and a better competitive yield advantage for stocks. It did this by doubling price/earnings for the Dow in the face of a collapse in actual earnings. But in the period ahead earnings must rise or interest rates must continue to decline–in order for the advance in stocks to be sustained. This is the reason for the intense, really incredible focus on discount rate cuts in today's markets. Consciously or unconsciously, Wall Street knows that this market is being spoon-fed by declining interest rates.

Question: Russell, do you think that interest rates can continue to decline?

Answer: I am skeptical. With the Federal budget due to rise perhaps by 50% by 1986, with corporations still very illiquid and in need of raising money, and with states and cities facing severe deficits and the need for new bond issues, there is going to be increased pressure on the money markets in coming months. Moreover, if there is any real recovery in business there will also be a chronic need for new money in this area.

One of the great questions now is whether the nation, if it stays in recession, can hold down its need for funds. If the recession continues and the deficits mount, then the need for funds could rise even while business remains in the tank. This would be the worst-case formula. The market (as of now) obviously doesn't think this will occur.

Question: So what is the market telling us now?

Answer: As I interpret it, the market is telling us (or hoping) that business will hold up, perhaps rising slightly but not getting terribly exciting, and all the while money rates will tend to remain at a low level because business won't need huge infusions of new money. In that way, the P/E ratio for the Dow, for instance, can hold above 10 even though business is just

fair or moving sideways. The market is hoping for no depression and no boom and a favorable continuing ratio between stock and bond yields.

INVESTMENT POSITION: If this market continues to correct and if the PTI continues to hold near its 1388 high, I've got to say that the situation will look technically impressive. I'm a firm believer in giving the market time to show its hand, and often the first hand it shows is not the correct one (Wall Street thrives on deception).

I'm also a great believer in "keeping it simple." In investing, keeping it simple means buying good no-loan funds rather than beating your brains out trying to pick the top stocks and thereby outdoing the professionals.

In the next Letter I'll list some of the no-loads that I like, but you can start with Neuburger Berman's Guardian Mutual and Fidelity's Equity Income as two of my favorites.

Gold is looking better and better, and I've already recommended ASA and Campbell. Those two together with Maple Leafs or Krugerrands are all you need (again, keep it simple).

NOTES & QUOTES: Paula and I returned from our whirlwind trip to Hawaii on November 17. The first day of the trip was a classic horror story. Our United Airlines plane was 2½ hours late in taking off because of a failed instrument. In that 2½ hours (don't ask me how) we both developed flu, a situation which lasted through the first day. We arrived in Honolulu at the lovely Kahala Hilton and had dinner with Burt Dohman-Ramirez and his beautiful wife (he's editor of the Wellington Letter). From there we headed for Maui, island of balmy weather, 75 degree water, mediocre (and that's charitable) food, and the beautiful Hyatt Regency Hotel.

The hotel was sold out at fat prices, which tells you something about the split in America and its economy. At the hotel were stock brokers, insurance men, computer people, doctors, lawyers. Absent were steel workers, copper workers, construction men, etc. "It's incredible," I told Paula, "Here's a luxury hotel sold out while half of America is in severe recession and our heavy industry is in depression. Can this nation survive and prosper on service industries alone? I guess we'll find out in due time."

Another observation: Maui is remote, a lovely island of pineapples and sugarcane. But the Wall Street Journal was delivered to the hotel every morning at 9A.M. And the TV cable is miraculously piped into every room along with Turner's 24-hour news station. The world is getting smaller–even while its debts are growing larger.

While floating around in the tepid waters, this thought sifted lazily into my brain. I had just read the WSJ, and as I gazed up at the cloud-shrouded mountains of Maui I said to myself, "There are just too many crisis-possibilities in the world today. The states and cities are (along with the Federal government) all going into deficit. The underdeveloped nations are sinking in debt, the US balance-of-payments picture has grown dismal, factory usage has sunk to 68.5% (lowest in 35 years), "smokestack America" is in a depression even while the service businesses continue to do well. Unemployment creeps higher. The list of situations that can erupt is growing longer and longer. And I find it increasingly difficult to believe that it can all be held together indefinitely.

Evidently, Mr. Volcker feels the same way, and he is calling for new safeguards just in case the world banking system goes up in smoke. What's the Volcker solution? IMF credits, bank credits, safety-net credits, more and more credits. The list of world credits is growing so huge that only the computers can comprehend and handle the numbers. And I say to myself as the warm waves roll over my shoulders, "How long can all these credits continue to hold together? How long can the world continue to float?" And the balmy breezes of Maui whisper, "Russell, you're floating and the world credits are floating. Relax, stop worrying, everything will be all right. "Sure, I answer, "Sure it will. How could I ever think differently."

* *

World leaders (a few of them) are intensely worried by the flow of events. Paul Volcker said last week that "relevant authorities and international institutions" must act to prevent the crisis that would come if developing countries were to default. Volcker noted that at some point banks will have to reduce their lending to developing countries, but for now they must stretch out repayments to "protect their own interests." What Volcker means is that as banks seek to protect themselves by cutting down loans to developing nations, the resultant shrinkage of new credits could send the countries (and the banks) into collapse.

Last week James Reston of the NY Times interviewed Helmut Schmidt, Chancellor of West Germany for the last eight years. I thought some of that interview was well worth reprinting here:

"Let's talk about the state of the world economy," he said. "I am deeply troubled.

"I have the feeling that we are now in the second phase of a world depression . . . I don't want to forecast any mischievous dramas or tragedies, but I very clearly see dramatic developments as being possible."

What he sees or fears is an even more serious crisis at the end of this winter, when unemployment runs out of hand in the United States, West Germany, Britain, France and maybe even Japan.

On top of that, he adds, we might see cases before next spring when enormous efforts are necessary to prevent some large countries from going bankrupt. He was not talking about Poland or Romania, he said, but about Mexico, Brazil, Yugoslavia and Argentina, among others.

"If an international banking crisis, on top of the unemployment crisis, should occur," he observed, "we'll be in deep trouble and the lack of leadership in the world will make itself felt.

"Leadership would necessitate at least partial analysis of the facts; secondly, a concept of what to do; and thirdly, more difficult, some way to get governments and central banks to act in a concerted way that leads to a mosaic of benevolent action."

The deficit in the currency market, he said, now equals about $2,000 billion — 10 times greater than the international indebtedness 10 years ago.

"There is no concerted control of that," he maintains. "There isn't even any international center for evidence. It has got totally out of surveillance by central banks.

"It started in places like the city of London, Luxembourg, Antigua, other islands of the Caribbean, and now it has gone into New York City. Nobody is controlling the prudence of all this credit. There is no lender of last resort to go to if something happens. It's a dangerous situation."

Schmidt didn't spare the United States in his criticism. The Reagan administration, he said, was among those governments that take economic steps with no regard to what it means to the rest of the world and is contributing to the crisis. So

we are now faced, he insisted, with more than a financial problem.

"It goes much deeper," he said. "The masses in the Western democracies in Europe will not just suffer like the Russian or the Chinese masses.

"But if that amount of unemployment hits – Britain is heading for 4 million unemployed at the end of this winter; Germany may be staying at 2.5 million; France more than Germany – and the combination of the financial crisis and the economic crisis will bring things to a head in public consciousness."

"Don't depict me as someone who is so deeply afraid of oncoming developments because I am personally being influenced by my resignation," he said. "That is not true. I was deeply concerned about the world economic situation already over the last 12-18 months ... I am quiet in my mind.

"As you know, I couldn't have stood it over a long period (he has a pacemaker in his heart). I'd find too many problems at one time ... But I do have the feeling that something is urgently necessary, within the next couple of months, to draw attention to what I think is now emerging as the second depression of this century."

* *

With huge daily trading in options, futures, matching shorts and various arbitrage techniques, I wonder increasingly whether many of the time-honored techniques of market analysis are worth a damn today. For instance Shearson Vice-President David C. Reif sent me a report he researched on the short interest. On studying the current record short interest, Reif writes: "To my utter amazement, 93,196,581 or 77% of the total short interest was in only 354 option stocks . . . . " So the question is, "What does the short interest mean today? Is the great bulk of it simply in arbitrage situations with options matched against shorts?"

One thing is clear. The options and futures situation is adding great volatility to a market that is already boiling with excitement. Thus, the arrival of the daily 75 to 100 million share day on the NYSE. Personally, I continue to believe that the stock market is our best barometer of coming events in the economy. But the barometer has a lot of "Las Vegas Hot Sauce" in it today. And maybe that tells us something about the speculative and tentative state of the American economy as well.

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In the current Business Week there's an interesting story about Richard Dennis, commodity trader, who reportedly has raked in profits of $40 to $50 million this year. Dennis is quoted as follows: "There are no final victories. So you have to leave the good days, as well as the bad days, at the office. Trading is a high wire act, and the trader who is in it for the psychological voltage will sooner or later get shocked." Dennis has also known losses, and on a single day in 1980 he took a loss of almost $5 million. States Dennis, "The trader who is averse to losses is in the wrong business."

I couldn't agree more. Many people are indeed averse to losses (and there's nothing wrong with that). So it is well to know yourself BEFORE you engage in stock or commodity trading. If you are a slow accumulator (as opposed to a trader) you are on the way to taking a psychological and financial beating if you trade. Personally, I prefer the "magic" of compounding rather than the excitement of trading, but because of that preference I have developed two "talents" (1) I am very patient, (2) I never get swept away by what everyone says the market "is going to do."

Speaking of trading, Julian Snyder (publisher of the widely-read *"Moneyline"* had dinner with us last week in La Jolla. Julian has done a great deal of research on the US and world banking system, and he says that they are both "technically broke." He says what is happening now in banking is "unreal, absolute fantasy." But "the world keeps turning," he reflects, and confidence in the system somehow continues.

As to trading, Julian has come out with a new book, *"The Way of the Hunter-Warrior"* in which he likens trading to the art of Samurai. It's a fascinating little book subtitled "How to Make a Killing in Any Market" (Richardson & Snyder $12.95). Julian is a veteran trader, and loves the fact that gold can now be traded around the world on a 24-hour basis.

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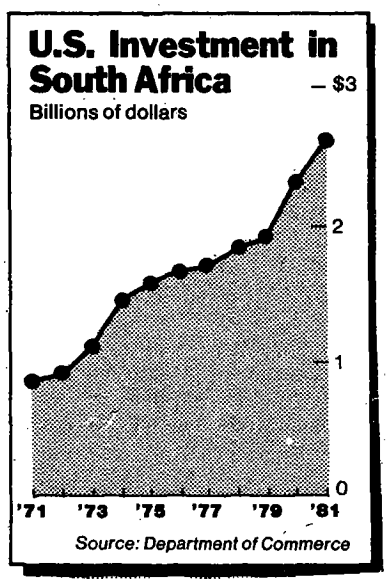
From our "It Ain't What You Say, It's What You Do" Dept: Despite all sorts of threats, boycotts and warnings from liberals, US investments in S. Africa continue to rise. Those subscribers who wondered why I recommended ASA as a buy in the face of S. Africa racial problems can take heart with this chart. US corporations obviously take a hopeful view of the S. African situation. To put it another way, go argue with a 13.3% rise in S. African investments during 1981.



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Did you ever wonder what really goes on during those auctions of collectibles? Friend Mike Kaller is conducting a seminar, plus auction of some great stamp rarities at the Plaza Hotel, NYC, Dec. 2 and 12. Mike is a leading stamp expert, his wife Judy is a top coin expert, and there will be others to give you behind-the scenes facts and collectibles. Write Myron Kaller, Barclays Bank Building, 333 N. Broadway, Jericho, NY 11753 for details.

Another good friend, R.E. McMaster, Jr., has published a book, "Wealth for All," and it's a very informative book. RE is one of those rare human beings, an original thinker. But he's an original thinker with one great advantage–he knows and understands markets. RE runs a commodity service, and how he finds time to write books as well–is beyond me. Like so many of us who believe that the only true path for man is in each person taking responsibility for himself, RE is a true beliver in free markets

and free people. The book contains a hoard of original and useful ideas and I recommend it ($14.95, hard cover from A.N. Inc., PO Box 67, Whitefish, Montana 59937).

LATE NOTES: Take another look at the action of the D-J Utility Average on the page 1 chart. The Utilities tend to be a bellwether for the market, and even though they are very interest rate-sensitive, the Utilities have been heading down ever since their October 11 high of 122.83. So far, the decline in Utilities has been rather leasurely. But if the Utility Average breaks below 114 I would take that as a distinct danger signal for the stock market in general.

GOLD: This is how a *New York Times* front page story (Nov. 25) begins. And I find myself wondering not about the

> **Not since the Depression of 50 years ago have the nations of the world faced such a bewildering multitude of economic and financial problems. In country after country, as if caught in a global epidemic, the world is afflicted with high unemployment and falling production and is beset by sagging trade, failing businesses and huge foreign debts.**
>
> **"There is hardly a place in the world where countries are not in economic difficulty," says George W. Ball, Under Secretary of State in the Kennedy and Johnson Administrations and now a consultant to Lehman Brothers Kuhn Loeb. "The Soviet Union and Communist countries are in desperate trouble, and in the West it is hard to find a bright spot."**
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> **Robert D. Hormats, who stepped down as Assistant Secretary of State for Economic and Business Affairs in August to become director of Goldman, Sachs International, calls today's array of problems "the greatest test to the prosperity of the postwar period that the world has faced."**

answer to the problem; no, I find myself wondering what the politicians' answer to the problem will be. My answer would be simple–I never would have let it go this far. I never would have allowed these debts. I never would have mortgaged the future for today's nonsense. But it's done. The world is in recession, the world is broke, the world is in hock up to its collective eyeballs.

So what's the answer? the Answer is probably going to be more and bigger credits–with a showcase pretense of some "austerity." What happens when billions of more credits are extended to cover debts and expenses? For one thing, the value of currencies decline. And already the dollar is beginning to slide against major currencies. Why? Two reasons: (1) The markets are beginning to discount huge national and international bailouts with most of the bailouts and loans based on new dollar credits. (2) The dollar is high-priced now and that high price is killing US exports. So US officials are happy to let the dollar sink. They're encouraging it.

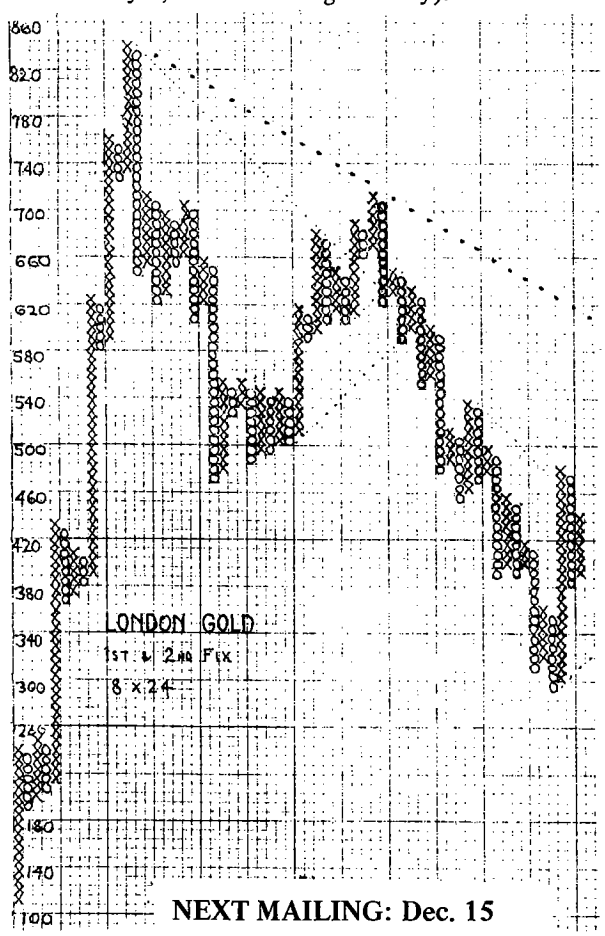
Now as you might guess, all this is not lost on gold. Hardly. With commodities in the doghouse, with inflation down to maybe 5%, gold is still holding above 400. And it's tenacity is surprising a lot of people. But when you think of what's coming up (as outlined above), you shouldn't be too surprised.

Last week gold suddenly popped up to the 427-430 area. Why? No one knows for certain, but I did note that the US is running a trade deficit (imports over exports) of $42 billion. Even worse, the Federal deficit for the single month of October was a record $26 billion (that's at an annual rate of over $300 billion)! Maybe that was the reason for the sudden gold spurt. But regardless of reasons, it's clear (as I've been saying for many months) that gold is in a primary bull trend.

The moving average studies of gold have worked well, and right now the 50-week (primary) moving average of gold is rising at a rate of 1-2 points a week. The latest figure is 395. The 13-week MA for gold is 410. And the 5-week MA is 413. Thus, all the moving averages are rising, they are all in bullish juxtaposition to each other, and the spot price of gold is pushing above even the 5-week (the most sensitive) moving average.

My long-term P & F chart of gold shows that a price around 490 would constitute a massive breakout for gold. And I feel that just as 300 was a base for many months, the 400 level is a base now.

What do we do about gold? I've been recommending a total gold position of about 10% (between gold coins and gold stocks). At this point, I would say that the total gold position can be raised to about 15% of assets or (in the case of real hard money oriented subscribers) up to 20%. I like the way gold is acting here. The gold shares have been outstanding performers. I feel all that is needed to send gold on its way (technically) is my ratio of gold to common stocks to switch in favor of gold (it hasn't done this yet, but it is veering that way).



NEXT MAILING: Dec. 15